

PROXYMED INC /FT LAUDERDALE/

Form 10-Q

November 09, 2005

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q**

(Mark One)

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2005

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number: **000-22052**

PROXYMED, INC.

(Exact name of registrant as specified in its charter)

Florida

(State or other jurisdiction of
incorporation or organization)

**1854 Shackleford Court, Suite 200, Norcross,
Georgia**

(Address of principal executive offices)

65-0202059

(I.R.S. Employer
Identification No.)

30093

(Zip Code)

(770) 806-9918

(Registrant's telephone number)

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether registrant is an accelerated filer (as defined by Rule 12b-2 of the Securities Exchange Act of 1934). Yes No

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Securities and Exchange Act of 1934) Yes No

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

**Common Stock, \$.001 Par Value
12,704,087 Shares as of November 9, 2005**

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ITEM 1.**PROXYMED, INC. AND SUBSIDIARIES**
Consolidated Balance Sheets (amounts in thousands except for share and per share data)

| Assets | (Unaudited) September 30, 2005 | December 31, 2004 |
|---|---|-------------------------|
| Current assets: | | |
| Cash and cash equivalents | \$ 6,756 | \$ 12,374 |
| Accounts receivable trade, net of allowance of \$4,306 and \$3,168 respectively | 16,335 | 17,591 |
| Other receivables | 110 | 312 |
| Inventory, net | 1,163 | 1,775 |
| Other current assets | 1,567 | 1,399 |
| Total current assets | 25,931 | 33,451 |
| Property and equipment, net | 4,303 | 4,801 |
| Goodwill, net | 26,444 | 93,604 |
| Purchased technology, capitalized software and other intangible assets, net | 18,746 | 52,305 |
| Restricted cash | 75 | 75 |
| Other long-term assets | 132 | 167 |
| Total assets | \$ 75,632 | \$ 184,403 |

Liabilities and Stockholders Equity

| | | |
|--|--------|----------|
| Current liabilities: | | |
| Notes payable and current portion of long-term debt | \$ 637 | \$ 2,178 |
| Related party debt | | 18,394 |
| Accounts payable and accrued expenses | 9,928 | 8,889 |
| Accrued compensation costs | 3,842 | 4,748 |
| Deferred revenue | 419 | 691 |
| Income taxes payable | 1,037 | 215 |
| Total current liabilities | 15,863 | 35,115 |
| Convertible notes | 13,137 | 13,137 |
| Other long-term debt | 12,129 | 206 |
| Long-term deferred revenue and other long-term liabilities | 2,137 | 863 |
| Total liabilities | 43,266 | 49,321 |

Commitments and contingencies (Note 9)

Stockholders' equity:

Series C 7% Convertible preferred stock \$.01 par value.

Authorized 300,000 shares; issued 253,265 shares;
outstanding 2,000 shares; liquidation preference \$200

Common stock \$.001 par value. Authorized 30,000,000

shares; issued and outstanding 12,704,087 and

12,626,567 shares, respectively

Additional paid-in capital

Accumulated deficit

Unearned compensation

Total stockholders' equity

Total liabilities and stockholders' equity

| | | |
|--|-----------|-----------|
| | 13 | 13 |
| | 239,927 | 239,255 |
| | (207,529) | (104,073) |
| | (45) | (113) |

| | |
|--------|---------|
| 32,366 | 135,082 |
|--------|---------|

| | |
|-----------|------------|
| \$ 75,632 | \$ 184,403 |
|-----------|------------|

See notes to the unaudited consolidated financial statements.

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PROXYMED, INC. AND SUBSIDIARIES
Consolidated Statements of Operations
(unaudited)

(amounts in thousands except for share and per share data)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|------------|------------------------------------|------------|
| | 2005 | 2004 | 2005 | 2004 |
| Net revenues: | | | | |
| Transaction fees, cost containment services and license fees | \$ 15,514 | \$ 20,219 | \$ 52,699 | \$ 55,807 |
| Communication devices and other tangible goods | 2,255 | 2,292 | 7,565 | 11,858 |
| | 17,769 | 22,511 | 60,264 | 67,665 |
| Costs and expenses: | | | | |
| Cost of transaction fees, cost containment services and license fees, excluding depreciation and amortization | 4,539 | 5,863 | 17,867 | 16,041 |
| Cost of laboratory communication devices and other tangible goods, excluding depreciation and amortization | 1,286 | 1,929 | 3,013 | 9,856 |
| Selling, general and administrative expenses | 11,933 | 12,562 | 37,122 | 35,438 |
| Depreciation and amortization | 2,521 | 2,607 | 7,687 | 7,086 |
| Write-off of impaired assets | 95,675 | | 96,416 | |
| | 115,954 | 22,961 | 162,105 | 68,421 |
| Operating loss | (98,185) | (450) | (101,841) | (756) |
| Interest expense, net | 419 | 503 | 1,440 | 1,379 |
| Other (income) expense | 175 | | 175 | (133) |
| Loss before income taxes | (98,779) | (953) | (103,456) | (2,002) |
| Provision for income taxes | | 75 | | 225 |
| Net loss | \$ (98,779) | \$ (1,028) | \$ (103,456) | \$ (2,227) |
| Basic and diluted loss per share | \$ (7.78) | \$ (0.08) | \$ (8.17) | \$ (0.20) |

| | | | | |
|---|------------|------------|------------|------------|
| Basic and diluted weighted average shares outstanding | 12,703,702 | 12,626,066 | 12,665,084 | 11,278,954 |
|---|------------|------------|------------|------------|

See notes to the unaudited consolidated financial statements.

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Table of Contents**PROXYMED, INC. AND SUBSIDIARIES****Consolidated Statements of Cash Flows****(unaudited)****(amounts in thousands)**

| | Nine Months Ended September 30, | |
|---|------------------------------------|------------|
| | 2005 | 2004 |
| Cash flows from operating activities: | | |
| Net loss | \$ (103,456) | \$ (2,227) |
| Adjustments to reconcile net loss to net cash provided by (used in) operations: | | |
| Depreciation and amortization | 7,687 | 7,086 |
| Provision for doubtful accounts | | 681 |
| (Gain) loss on settlement of liability | 175 | (133) |
| Write-off of impaired assets | 96,416 | |
| Stock option compensation charges | 240 | 204 |
| Changes in assets and liabilities: | | |
| Accounts and other receivables | 3,458 | 1,747 |
| Inventory | 612 | (1,042) |
| Other current assets | 235 | 410 |
| Accounts payable and accrued expenses | (3,092) | (1,945) |
| Accrued expenses of PlanVista paid by ProxyMed | | (4,011) |
| Deferred revenue | (222) | 94 |
| Income tax payable | 2,344 | |
| Other current liabilities | (112) | (868) |
| Net cash provided by (used in) operating activities | 4,285 | (4) |
| Cash flows from investing activities: | | |
| Net cash acquired in acquisition | | 782 |
| Capital expenditures | (1,640) | (2,613) |
| Capitalized software | (400) | (971) |
| Collection of notes receivable | | 180 |
| Proceeds from sale of fixed assets | | 4,499 |
| Decrease in restricted cash | 72 | 115 |
| Payments for acquisition-related costs | | (884) |
| Net cash (used in) provided by investing activities | (1,968) | 1,108 |
| Cash flows from financing activities: | | |
| Net proceeds from sale of common stock | 500 | 24,100 |
| Proceeds from exercise of stock options and warrants | | 8,766 |
| Draws on line of credit | 28,125 | 4,900 |
| Repayment of line of credit | (15,996) | (4,900) |
| Payment of related party note payable | (18,394) | |
| Payment of notes payable, capital leases and long-term debt | (2,170) | (27,089) |
| Net cash (used in) provided by financing activities | (7,935) | 5,777 |

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| | | |
|---|----------|-----------|
| Net (decrease) increase in cash and cash equivalents | (5,618) | 6,881 |
| Cash and cash equivalents at beginning of period | 12,374 | 5,333 |
| Cash and cash equivalents at end of period | \$ 6,756 | \$ 12,214 |
| Supplemental disclosure of cash flow information: | | |
| Cash paid for interest | \$ 1,334 | \$ 1,259 |
| Cash paid for income taxes | 209 | |
| Non-cash investing and financing information: | | |
| Issuance of 3.6 million shares of common stock for PlanVista acquisition | \$ | \$ 59,800 |
| Increase in purchase price of acquisition related to net settlement of New York state tax liability | \$ 968 | \$ |

See notes to the unaudited consolidated financial statements.

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ProxyMed, Inc. and Subsidiaries

**Notes to Consolidated Financial Statements
(Unaudited)**

(1) **Summary of Significant Accounting Policies**

- (a) **Basis of Presentation** The accompanying unaudited consolidated financial statements of ProxyMed, Inc. and its subsidiaries (ProxyMed or the Company) and the notes thereto have been prepared in accordance with the instructions of Form 10-Q and Rule 10-01 of Regulation S-X of the Securities and Exchange Commission (the SEC) and do not include all of the information and disclosures required by accounting principles generally accepted in the United States of America. However, such information reflects all adjustments (consisting of normal recurring adjustments), which are, in the opinion of management, necessary for a fair statement of results for the interim periods.

The results of operations for the three and nine months ended September 30, 2005 are not necessarily indicative of the results to be expected for the full year. The unaudited consolidated financial statements included herein should be read in conjunction with the audited consolidated financial statements and the notes thereto included in ProxyMed s Annual Report on Form 10-K/A for the year ended December 31, 2004 as filed with the SEC on March 31, 2005 (10-K/A).

- (b) **Revenue Recognition** Revenue is derived from ProxyMed s Transaction Services and Laboratory Communication Solutions segments.

Revenues in the Company s Transaction Services segment are recorded as follows:

For revenues derived from insurance payers, pharmacies and submitters, such revenues are recognized on a per transaction basis or flat fee basis in the period the services are rendered.

Revenue from the Company s medical cost containment business is recognized when the services are performed and are recorded net of estimated allowances. These revenues are primarily in the form of fees generated from discounts the Company secures for payers that access the Company s provider network (see Note 1c).

Revenues associated with revenue sharing agreements are recorded as gross revenue on a per transaction basis or a percentage of revenue basis and may involve increasing amounts or percentages based on transaction or revenue volumes achieved. This treatment is in accordance with Emerging Issues Task Force Consensus No. 99-19, Reporting Revenue Gross as a Principal Versus Net as an Agent.

Revenue from certain up-front fees is recognized ratably over three years, which is the expected life of the customer. This treatment is in accordance with Staff Accounting Bulletin No. 104, Revenue Recognition (SAB No. 104).

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Revenue from support and maintenance contracts is recognized ratably over the contract period.

Revenues in the Company's Laboratory Communication Solutions segment are recorded as follows:

Revenue from support and maintenance contracts is recognized ratably over the contract period.

Revenues from the sale of inventory and manufactured goods is recognized when the product is delivered, price is fixed or determinable, and collectibility is probable. This treatment is in accordance with SAB No. 104.

Revenue from the rental of laboratory communication devices is recognized ratably over the period of the rental contract.

- (c) **Reserve for Revenue Adjustments, Doubtful Accounts and Bad Debt Estimates** ProxyMed relies on estimates to determine the revenue adjustments, bad debt expense and the adequacy of the Company's reserve for doubtful accounts receivable. These estimates are based on ProxyMed's historical experience, including historical collection ratios, and the industry in which the customer operates. If the financial condition of a customer were to deteriorate, resulting in an impairment of its ability to make payments, additional allowances are made.
- (d) **Net loss per share** Basic net loss per share of common stock is computed by dividing net loss by the weighted average shares of common stock outstanding during the period. Diluted net loss per share reflects the potential dilution from the exercise or conversion of securities into common stock; however, the following shares were excluded from the calculation of diluted net loss per share because their effects would have been anti-dilutive:

| (unaudited) | Nine months ended | |
|--|-------------------|-------------|
| | September 30, | |
| | <u>2005</u> | <u>2004</u> |
| Common shares excluded in the computation of net loss per share: | | |
| Stock Options | 31,594 | 63,888 |
| | 31,594 | 63,888 |

- (e) **Stock Based Compensation** The Company applies Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB No. 25), and related interpretations in accounting for its stock-based compensation plans. The Company measures compensation expense related to the grant of stock options and stock-based awards to employees (including independent directors) in accordance with the provisions of APB No. 25. In accordance with APB No. 25, compensation expense, if any, is generally based on the difference between the exercise price of an option, or the amount paid for an award, and the market price or fair value of the underlying common stock at the date of the award or at the measurement date for variable awards. Stock-based compensation arrangements involving non-employees are accounted for under Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation (SFAS No. 123) as amended by SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure (SFAS No. 148), under

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which such arrangements are accounted for based on the fair value of the option or award.

Under SFAS No. 123, as amended by SFAS No. 148, compensation cost for the Company's stock-based compensation plans would be determined based on the fair value at the grant dates for awards under those plans. Had the Company adopted SFAS No. 123 in accounting for our employee stock option plans, its consolidated net loss and net loss per share for the three and nine months ended September 30, 2005 and 2004 would have been adjusted to the pro forma amounts indicated as follows:

| In thousands except for per share data (unaudited) | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|------------|------------------------------------|------------|
| | 2005 | 2004 | 2005 | 2004 |
| Net loss, as reported | \$ (98,779) | \$ (1,028) | \$ (103,456) | \$ (2,227) |
| Addback charges already taken for intrinsic value of options | 7 | 36 | 240 | 92 |
| Deduct: Total stock-based compensation expense determined under fair value based method for all awards | (10) | (307) | (1,103) | (1,613) |
| Pro forma net loss | \$ (98,782) | \$ (1,299) | \$ (104,319) | \$ (3,748) |
| Loss per common share: | | | | |
| Basic and Diluted as reported | \$ (7.78) | \$ (0.08) | \$ (8.17) | \$ (0.20) |
| Basic and Diluted pro forma | \$ (7.78) | \$ (0.10) | \$ (8.24) | \$ (0.33) |

In May 2005, the Company granted its new CEO stock options to purchase 600,000 shares of ProxyMed's common stock at an exercise price of \$6.45 per share. Pursuant to the aforementioned stock option agreements: 400,000 shares vest monthly over 4 years with 1/48 vesting each month. The other 200,000 shares have market triggers when the Company's common stock reaches market prices of \$15, \$20, \$25 and \$30 such that each 50,000 shares will vest when the closing price per share of the Company's common stock reaches and maintains each trigger amount for ten consecutive trading days.

In December 2004, the Company's new Chairman and Interim CEO was granted stock options to purchase 75,000 shares of ProxyMed's common stock at an exercise price of \$7.10 per share in connection with his consulting agreement with the Company. Such options expire in 10 years and vest ratably over the first 12 months. The total charge for these stock options is \$172,800 and is being recorded ratably over the first twelve vesting months. In January 2005, the Interim CEO was granted stock options to purchase 25,000 shares of ProxyMed's stock at the market value on the date of issuance of \$9.87 per share in his capacity as Chairman of the Board. These options expire in 10 years and vest ratably over the first 12 months. In May 2005, the Company terminated its consulting agreement with the Chairman of the Board. This event triggered acceleration of the vesting of the stock options under the consulting agreement. As a result, the Company recorded additional compensation expense of \$86,600 for the period ended June 30, 2005.

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(f) New Accounting Pronouncements In May 2005, the Financial Accounting Standards Board (FASB) issued (SFAS No. 154), Accounting Changes and Error Corrections . SFAS No. 154 requires retrospective application of a voluntary change in accounting principle to prior period financial statements unless it is impractical. SFAS No. 154 also requires that a change in method of depreciation, amortization, or depletion for long-lived, non-financial assets be accounted for as a change in accounting estimate effected by a change in accounting principal. SFAS No. 154 replaces APB Opinion No. 20, Accounting Changes, and SFAS No. 3, Reporting Accounting Changes in Interim Financial Statements. SFAS No. 154 is effective for fiscal years beginning after December 15, 2005. The Company does not expect the adoption of the provision of SFAS No. 154 to have a material impact on its result of operations or financial condition.

In March 2005, the SEC issued Staff Accounting Bulletin (SAB) No. 107. This SAB provides guidance related to the application of SFAS No. 123(R), Shared-Based Payments (Revised 2004) for transactions with non-employees, the transition from nonpublic to public entity status, valuation methods, the accounting for certain redeemable financial instruments issued under share-based payment arrangements, the classification of compensation expense, non-GAAP financial measure, first-time adoption of Statement 123(R) and disclosures in Management s Discussion and Analysis (MD&A) subsequent to adoption of Statement 123(R). The revised effective date of SFAS No. 123(R) is for annual reporting periods beginning after June 15, 2005. The adoption date for the Company is January 1, 2006. The Company has not completed the process of evaluating the impact that will result from adopting SFAS No. 123(R) and is therefore unable to disclose the impact that adoption will have on the Company s financial position and results of operations.

In September 2004, the Financial Accounting Standards Board (FASB) issued Emerging Issues Task Force (EITF) No. 04-8, Accounting Issues Related to Certain Features of Contingently Convertible Debt and the Effect on Diluted Earnings per Share (EITF No. 04-8). EITF No. 04-8 addresses when the dilutive effect of contingently convertible debt instruments should be included in diluted earnings per share and requires that contingently convertible debt instruments are to be included in the computation of diluted earnings per share regardless of whether the market price or other trigger has been met. EITF No. 04-8 also requires that prior period diluted earnings per share amounts presented for comparative purposes be restated. EITF No. 04-8 is effective for reporting periods ending after December 15, 2004. As a result of the issuance of EITF No. 04-8, shares convertible from the Company s \$13.1 million convertible notes may be required to be included in the calculation of the Company s earnings per share in periods of net income; however, the FASB has yet to reach a conclusion as to the effect of non-market price triggers on earnings per share calculations in situations where the instrument contains only non-market price triggers, such as the Company s convertible notes, and therefore the impact on the consolidated financial statements is not determinable at this time.

In November 2004, the FASB issued SFAS No. 151, Inventory Costs, an amendment of ARB No. 43, Chapter 4. This Statement clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage) and requires that those items be recognized as current-period charges regardless of whether

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they meet the criterion of so abnormal under ARB No. 43. The provisions of this Statement shall be effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The Company does not expect the adoption of the provision of SFAS No. 154 to have a material impact on its results of operations or financial condition.

(2) **Acquisition of PlanVista**

On March 2, 2004, the Company acquired all of the capital stock of PlanVista Corporation (PlanVista), a publicly-held company that provides medical cost containment and business process outsourcing solutions, including claims repricing services, for the medical insurance and managed care industries, as well as services for healthcare providers, including individual providers, preferred provider organizations and other provider groups, for 3,600,000 shares of the Company s common stock issued to PlanVista s shareholders. In addition, the Company assumed debt and other liabilities of PlanVista, and incurred \$1.3 million in acquisition related expenses. The value of these shares was \$59.8 million based on the average closing price of ProxyMed s common stock for the day of and the two days before and after the announcement of the definitive agreement on December 8, 2003 in accordance with EITF No. 99-12, Determination of the Measurement Date for the Market Price of Acquirer Securities Issued in a Purchase Business Combination. Additionally, the Company raised \$24.1 million in a private placement sale of the Company s common stock to various entities affiliated with General Atlantic Partners and Commonwealth Associates to partially fund repayment of PlanVista s debts and other obligations outstanding at the time of the acquisition.

The Company recently withdrew the tax appeal with the State of New York and entered into an installment payment agreement involving the tax years December 31, 1999 through December 31, 2001. The tax liability is \$3.1 million and it includes interest and penalties through June 30, 2005. Payment on the tax liability will be repaid in 30 equal installments beginning in October 2005. Additionally, the Company entered into an agreement with a third party to be reimbursed for 70% of the tax liability ultimately agreed to with the State of New York, but not to exceed \$2 million. In September 2005, the Company received the \$2.0 million related to the agreement with the third party. The Company had accrued a tax liability of \$0.1 million as of December 31, 2004 related to this tax appeal. As a result of the third party agreeing to make reimbursement, the Company recorded a net adjustment to PlanVista s Goodwill in the amount of \$1.0 million in June 2005 (see Note 4). In September 2005, the State of New York reduced the penalties by \$0.1 million and the Company accordingly recorded an adjustment to Goodwill related to this tax liability.

The following unaudited pro forma summary presents the consolidated results of operations of both the Company and PlanVista as if the acquisition had occurred on January 1, 2004. The 2004 results include \$2.8 million of revenue from the manufacturing assets sold in June 2004. The pro forma results do not necessarily represent results that would have occurred if the acquisition had taken place on January 1, 2004, or of results that may occur in the future.

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| In thousands except for per share data (unaudited) | Nine Months Ended September 30, 2004 |
|---|---|
| Revenues | \$ 73,333 |
| Net loss | \$ (1,891) |
| Basic and diluted net loss per share of common stock | \$ (0.15) |

See Note 2 of the Audited Consolidated Financial Statements on ProxyMed's 2004 Form 10-K/A for complete detail pertaining to the PlanVista acquisition.

(3) Inventory

Inventory consists of the following as of the dates indicated:

| In thousands (unaudited) | September 30, 2005 | December 31, 2004 |
|--|--------------------------|-------------------------|
| Materials, supplies and component parts | \$ 365 | \$ 651 |
| Work in process | 62 | 32 |
| Finished goods | 736 | 1,092 |
| | \$ 1,163 | \$ 1,775 |

(4) Goodwill and other Intangible Assets

As a result of the Company's stock price decline and reorganization during the third quarter of 2005, the Company performed a goodwill impairment test as of September 30, 2005. In accordance with the provisions of SFAS No. 142, the Company used a discounted cash flow analysis which indicated that the book value of the Transaction Services segment exceeded its estimated fair value and that goodwill impairment had occurred. In addition, as a result of the goodwill analysis, the Company assessed whether there had been an impairment of the Company's long-lived assets in accordance with SFAS No. 144. The Company concluded that the book value of certain intangible assets was higher than their expected future cash flows and that impairment had occurred. In addition, the Company also reduced the remaining useful lives of its other intangible assets based on the foregoing analysis. Accordingly, the Company recorded a non-cash impairment charge of \$95.7 million at September 30, 2005 in its Transaction Services Segment. The charges included \$68.1 million impairment of goodwill and \$27.6 million impairment of certain other intangibles.

In June 2005, we recorded an impairment charge of \$0.7 million in our Laboratory Communications Solutions segment as a result of the substantial revenue decline of a certain customer. In accordance with the provisions of SFAS No. 144, we prepared a discounted cash flow analysis which indicated the carrying value of the intangible asset associated with this customer was greater than the fair value and the impairment had occurred.

In June 2005, the Company adjusted goodwill in the purchase price allocation of the PlanVista acquisition related to the New York State tax liability (see Note 2).

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The changes in the carrying amounts of goodwill, net, for the period ending September 30, 2005 by operating segment are as follows:

| In thousands | Laboratory | | |
|--|----------------------|--------------------------|-----------|
| | Transaction Services | Communications Solutions | Total |
| Balance as of December 31, 2004 | \$ 91,502 | \$ 2,102 | \$ 93,604 |
| Adjustment to Goodwill during the period | 875 | | 875 |
| Impairment charge | (68,035) | | (68,035) |
| Balance as of September 30, 2005 (unaudited) | \$ 24,342 | \$ 2,102 | \$ 26,444 |

The estimated useful lives and the carrying amounts of other intangible assets as of September 30, 2005 and December 31, 2004, by category, are as follows:

| In thousands | Estimated Useful lives | (unaudited) | | | December 31, 2004 | | | |
|------------------------|------------------------|--------------------|---------------------------------|--------------------|--------------------|-------------------|---------------------------------|-------------------|
| | | September 30, 2005 | September 30, 2005 | September 30, 2005 | September 30, 2005 | December 31, 2004 | December 31, 2004 | December 31, 2004 |
| | | Carrying Amount | Accumulated <u>Amortization</u> | Impairment Charge | Net | Carrying Amount | Accumulated <u>Amortization</u> | Net |
| Capitalized software | 3 years | \$ 2,976 | \$ (1,244) | \$ | \$ 1,732 | \$ 2,661 | \$ (769) | \$ 1,892 |
| Purchased technology | 7 years | 9,152 | (4,708) | | 4,444 | 10,342 | (4,738) | 5,604 |
| Customer relationships | 7 years | 34,282 | (6,966) | (19,746) | 7,570 | 34,283 | (4,324) | 29,959 |
| Provider network | 7 years | 16,200 | (2,565) | (8,635) | 5,000 | 16,200 | (1,350) | 14,850 |
| | | \$ 62,610 | \$ (15,483) | \$ (28,381) | \$ 18,746 | \$ 63,486 | \$ (11,181) | \$ 52,305 |

The estimates of useful lives for other intangibles assets were reduced based on the analysis performed under SFAS No. 144 as of September 30, 2005. Other intangible assets are being amortized on a straight-line basis. Amortization expense for the three and nine months ended September 30, 2005 and 2004 was \$1.8 million, \$5.6 million, \$1.8 million and \$4.6 million, respectively.

As of September 30, 2005, estimated future amortization of other intangible assets is as follows:

In thousands
(unaudited)

| | |
|-----------------------------|-----------|
| 2005 (remainder of year) | \$ 1,074 |
| 2006 | 4,180 |
| 2007 | 3,757 |
| 2008 | 3,039 |
| 2009 | 1,786 |
| 2010 | \$ 1,733 |
| | \$ 15,569 |

(5) Debt Obligations

- (a) Senior Debt - On April 18, 2005, the Company closed a new three year, \$15.0 million senior asset based facility which is secured by all assets of the combined entities with

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Wachovia Bank, N.A. The loan is based on qualified accounts receivable and historical cash flows. It bears interest at LIBOR (London Interbank Offering Rate) plus 2.7% and is paid monthly in arrears. This debt contains certain covenants. The principal debt covenants require the Company to maintain a bank balance of at least \$5.0 million and meet certain historical earnings as defined in the agreement. If the Company fails to meet any of the covenants, repayment of the debt outstanding under the revolving credit facility may be accelerated. The \$15.0 million loan reduces to \$12.5 million in June 2006 and is all due at maturity on April 17, 2008, absent an event of default. The Company used the proceeds from this facility and some of its cash to pay approximately \$18.9 million which constituted all of the Company's previous senior related party debt obligation and notes outstanding to former directors of PlanVista including all accrued interest.

During the second quarter of 2005, the Company defaulted on a financial covenant under this credit facility. It subsequently obtained a waiver of this default and has renegotiated the covenant.

During the third quarter of 2005, the Company was in compliance with all financial covenants related to this credit facility.

- (b) **Senior Debt** As a result of the acquisition of PlanVista, ProxyMed assumed and guaranteed a \$20.4 million secured obligation to PVC Funding Partners, LLC (an investment company related to Commonwealth Associates, LP and one of the Company's board members). This related party obligation was payable in monthly installments of \$0.2 million and was scheduled to mature with a balloon payment of \$17.6 million on May 31, 2005 and bore an interest rate of 10% (the obligation originally bore interest of 6% through November 2004), payable monthly in cash. This debt was paid in full on April 18, 2005.
- (c) **Convertible Notes** On December 31, 2002, the Company issued \$13.4 million in uncollateralized convertible promissory notes at 4% to the former shareholders of MedUnite as part of the consideration paid in the acquisition of MedUnite. Interest is payable quarterly in cash in arrears. The convertible promissory notes are payable in full on December 31, 2008 unless converted earlier upon the meeting of certain aggregate revenue triggers by the former shareholders. After an offsetting claim by ProxyMed in October 2003 in the amount of \$0.3 million, the outstanding balance of these notes is \$13.1 million. Additionally, as a result of the reduction in principal, the notes are now convertible into 716,968 shares of the Company's common stock subject to achieving certain revenue triggers. The first revenue trigger was met in the fourth quarter of 2003, however the second revenue trigger was not met in the second quarter of 2005.
- (d) **Notes Payable** In March 2003, the Company restructured \$3.4 million in accounts payable and accrued expenses acquired from MedUnite and outstanding at December 31, 2002 to one vendor by paying \$0.8 million in cash and financing the balance of \$2.6 million with an unsecured note payable over 36 months at 8% commencing in March 2003. The balance of this note payable at September 30, 2005 is \$0.3 million.
In April 2003, the Company financed a net total of \$2.0 million existing at December 31, 2002 from MedUnite to NDCHealth by issuing an unsecured note payable over 24 months at 6%. The balance of this note payable is \$0.3 million.

Table of Contents**(6) Equity Transactions**

During the three and nine months ended September 30, 2005, the Company granted 25,000 and 736,500 stock options, respectively, at exercise prices between \$6.45 and \$10.35 per share to officers and employees. These options are for ten-year terms and generally vest equally over four years following the date of the grant.

(7) Segment Information

ProxyMed operates in two reportable segments that are separately managed: Transaction Services and Laboratory Communication Solutions. Transaction Services includes transaction, cost containment and other value-added services principally between physicians and insurance companies (Payer Services and Submitter Services), and providers and pharmacies. Laboratory Communication Solutions includes the sale, lease and service of communication devices principally to laboratories and, through June 30, 2004, the contract manufacturing of printed circuit boards (Laboratory Services). As a result of a re-alignment of the Company's corporate overhead functions in the second quarter of 2004, ProxyMed now reports these expenses and assets as part of its Transaction Services segment.

The Company recorded a non-cash impairment charge of \$95.7 million at September 30, 2005 in its Transaction Services segment. The charges included \$68.1 million impairment of goodwill and \$27.6 million impairment of certain other intangibles (see Note 4).

| In thousands (unaudited) | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|----------------------|------------------------------------|------------|
| | 2005 | 2004 | 2005 | 2004 |
| Net revenues by operating segment: | | | | |
| Transaction Services | \$ 15,058 | \$ 18,999 | \$ 51,264 | \$ 52,117 |
| Laboratory Communication Solutions | 2,711 | 3,512 | 9,000 | 15,548 |
| | \$ 17,769 | \$ 22,511 | \$ 60,264 | \$ 67,665 |
| Net revenues by geographic location: | | | | |
| Domestic | \$ 17,769 | \$ 22,511 | \$ 60,264 | \$ 67,559 |
| International (1) | | | | 106 |
| | \$ 17,769 | \$ 22,511 | \$ 60,264 | \$ 67,665 |
| Operating income (loss) by operating segment: | | | | |
| Transaction Services | \$ (98,586) | \$ (959) | \$ (102,788) | \$ (1,123) |
| Laboratory Communication Solutions | 401 | 509 | 947 | 1,464 |
| Corporate | | | | (1,097) |
| | \$ (98,185) | \$ (450) | \$ (101,841) | \$ (756) |
| | September 30, 2005 | December 31, 2004 | | |
| Total assets by operating segment: | | | | |
| Transaction Services | \$ 69,433 | \$ 173,061 | | |
| Laboratory Communication Solutions | 6,199 | 11,342 | | |
| | \$ 75,632 | \$ 184,403 | | |

(1) Laboratory Communication Solutions segment only.

(8) Income Taxes

As of September 30, 2005, ProxyMed had a net deferred tax asset of approximately \$95.3 million, which was fully offset by a valuation allowance due to cumulative losses

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in recent years. Realization of the net deferred tax asset is dependent upon the Company generating sufficient taxable income prior to the expiration of the federal net operating loss carryforwards. The Company will adjust this valuation reserve if, during future periods, management believes the Company will generate sufficient taxable income to realize the net deferred tax asset. The provision for income taxes reported in the consolidated statement of operations for the three and nine months ended September 30, 2004 of approximately \$0.1 million and \$0.2 million, respectively, was related primarily to state income taxes.

(9) **Commitments and Contingencies**

- (a) **Litigation** In December of 2001, Insurdata Marketing Services, Inc. (IMS) filed a lawsuit against HealthPlan Services, Inc. (HPS), a former subsidiary of PlanVista, for unspecified damages in excess of \$75,000. The complaint alleges that HPS failed to pay commissions to IMS pursuant to an arbitration award rendered in 1996. On January 10, 2005, the court granted summary judgment to IMS on the issue of liability for the arbitration award. The Company filed an appeal on the issue of liability. On September 26, 2005 the Company entered into a settlement to pay a total of \$775,000 in exchange for a release from the entire claim, with an initial payment of \$225,000 and the rest due in equal installments over six months. On October 20, 2005 the first payment of \$225,000 was wired to IMS.

In early 2000, four named plaintiffs filed a class action against Fidelity Group, Inc. (Fidelity), HPS, Third Party Claims Management, and others, for unspecified damages. The complaint stems from the failure of a Fidelity insurance plan, and alleges unfair and deceptive trade practices; negligent undertaking; fraud; negligent misrepresentation; breach of contract; civil conspiracy; and RICO violations against Fidelity and its contracted administrator, HPS. Two principals of the Fidelity plan have been convicted of insurance fraud and sentenced to prison in a separate proceeding. The class has been certified and the case is proceeding in discovery. The Company is contesting the plaintiffs' claims vigorously, but is unable to predict the outcome of the case or any potential liability. Mediation is scheduled to be held on November 1, 2005.

In 2004, the Company filed a tax appeal in the State of New York contesting a Notice of Deficiency issued by the State of New York to PlanVista Solutions, Inc. The notice involved taxes claimed to be due for the tax years ending December 31, 1999 through December 31, 2001. The amount due, including interest and penalties through September 30, 2005 is \$3.1 million. The Company recently withdrew the tax appeal and entered into an installment payment agreement with the State of New York. Payment on the tax liability will be repaid in a lump sum of \$500,000 by October 30, 2005 and the remainder in equal installments beginning in November 2005 with the State of New York. The Company entered into an agreement with a third party to be reimbursed for 70% of the liability ultimately agreed to with the State of New York, but not to exceed \$2 million. The Company received the \$2.0 million payment from the third party in September 2005.

In December 2004, Honolulu Disposal, Inc. et al sued American Benefit Plan Administrators, Inc. (a former subsidiary of PlanVista Corporation) in the Circuit Court of the First Circuit of the state of Hawaii alleging damages of \$5,700,000 for failure to properly conduct a payroll audit during the period of 1982 through 1996. The Company

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is contesting the plaintiffs' claims vigorously, but is unable to predict the outcome of the case or any potential liability. The Company is seeking indemnification for defense costs and any liability for damages under the business contracts at issue in the litigation.

- (b) **Other** In connection with the Company's June 1997 acquisition of its PreScribe technology used in its Prescription Services business, the Company would be obligated to pay up to \$10 million to the former owner of PreScribe in the event of a divestiture of a majority interest in ProxyMed, or all or part of the PreScribe technology.

In connection with the Company's December 2002 acquisition of MedUnite, Inc., the Company signed an agreement with NDCHealth ("NDC"), restructuring a liability owed by MedUnite to NDC in the amount of \$4 million, in exchange for \$4 million of additional consideration in one or more commercial arrangements between NDC and ProxyMed. On August 30, 2005, in connection with an extension of our agreement with NDC to provide claims processing, NDC executed a release acknowledging this obligation is fully satisfied and that the Company has no further obligation with respect to the \$4 million of additional consideration.

- (c) **Leases** In January 2005, the Company renewed its corporate office lease in Norcross, Georgia for an additional 5 year term, commencing May 1, 2005 through April 30, 2010. The base lease payments for the renewal term total \$2.2 million. In May 2005, the Company negotiated a reduction of \$0.7 million of the base lease payments in lieu of leasehold improvements.

- (d) **Employment Agreements** The Company entered into employment agreements with certain executives and other members of management that provide for cash severance payments if these employees are terminated without cause. The Company's aggregate commitment under these agreements is \$0.8 million at September 30, 2005.

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ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Management's discussion and analysis of financial condition and results of operations (MD&A) is provided as a supplement to ProxyMed, Inc.'s (ProxyMed, we, our, or us) unaudited consolidated financial statements in this Form 10-Q and notes thereto and to the audited consolidated financial statements and the notes thereto including our Annual Report on Form 10-K/A for the year ended December 31, 2004 as filed with the Securities and Exchange Commission (SEC) on March 31, 2005.

Overview

We were incorporated in Florida in 1989 and we are a leading healthcare transaction services company providing Electronic Data Interchange (EDI), cost-containment services and related value-added products to physician offices, payers, medical laboratories, pharmacies and other healthcare institutions. Our broad existing connectivity to payers and providers positions us as the second largest independent medical claims clearinghouse in the industry, serving over 150,000 providers. Our cost containment business has the second largest Preferred Provider Organization (PPO) in terms of reach with over 400,000 providers contracted, and currently is sixth in terms of managed care lives accessed through us.

Our business strategy is to leverage our leadership position in connectivity services in order to establish ourselves as the premier provider of automated financial, clinical, cost containment, business outsourcing and administrative transaction services primarily between healthcare providers and payers, clinical laboratories and pharmacies.

Our electronic transaction processing services support a broad range of financial, clinical, and administrative transactions. To facilitate these services, we are completing the conversion of all of our non-clinical EDI clients to Phoenix , our secure, proprietary national electronic information network that provides physicians and other healthcare providers with direct connectivity to one of the industry's largest list of payers.

Our cost containment and business outsourcing solutions businesses are included in the Transaction Services segment since our acquisition of PlanVista Corporation (PlanVista) in March 2004, and are directed toward the medical insurance and managed care industries. Specifically, we provide integrated national PPO network access, electronic claims repricing, and network and data management to healthcare payers, including self-insured employers, medical insurance carriers, PPO's and third party administrators (TPAs).

We believe we are uniquely positioned in the marketplace to make a contribution that our competitors do not. The differentiators include our open electronic network for electronic transactions with no equity ownership in businesses engaged in the front-end (i.e., physician practice management software system vendors and other physician desk top vendors) or in the back-end (i.e., payers, laboratories and pharmacies). With our neutral position, we believe that we can better attract both front-end and back-end partners who may be more comfortable doing business with a non-competitive partner.

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Another competitive differentiator is our presence in the clinical market. With the nation's largest clinical laboratories as long-time customers, we have worked in partnership with them to develop customized laboratory communication tools and services.

Operating Segments

We operate in two reportable segments that are separately managed: Transaction Services and Laboratory Communication Solutions. Transaction Services includes EDI, cost containment and other value-added services principally between submitters (physicians, billing companies, hospitals, laboratories, and others) and payers (insurance companies, TPAs, Medicare, Medicaid, and others). Laboratory Communication Solutions includes the sale, lease and service of communication devices principally to laboratories and, through June 30, 2004, contract manufacturing. As a result of a re-alignment of our corporate overhead functions (i.e., executives, finance, legal, human resources, facilities and insurance) in the second quarter of 2004, we now report these expenses and assets as part of our Transaction Services segment. International sales were attributable to the manufacturing assets of the Laboratory Communication Solutions segment that were sold on June 30, 2004.

Our corporate headquarters is located in Norcross, Georgia, and our products and services are provided from various operational facilities located throughout the United States. We also operate our clinical computer network and portions of our financial and real-time production computer networks from a secure, third-party co-location site located in Atlanta, Georgia

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Results of Operations
Three Months Ended September 30, 2005 Compared to Three Months Ended September 30, 2004

| In thousands (unaudited) | Three Months Ended September 30, | | Three Months Ended September 30, | | Change \$ | Change % |
|---|----------------------------------|-------------------|----------------------------------|-------------------|------------|----------|
| | 2005 | % of Net Revenues | 2004 | % of Net Revenues | | |
| Net revenues: | | | | | | |
| Transaction Services | \$ 15,058 | 84.7% | \$ 18,999 | 84.4% | \$ (3,941) | -20.7% |
| Laboratory Communication Solutions | 2,711 | 15.3% | 3,512 | 15.6% | (801) | -22.8% |
| | 17,769 | 100% | 22,511 | 100% | (4,742) | -21.1% |
| Cost of sales: | | | | | | |
| Transaction Services | 4,357 | 24.5% | 5,856 | 26.0% | 1,499 | 25.6% |
| Laboratory Communication Solutions | 1,468 | 8.3% | 1,936 | 8.6% | 468 | 24.2% |
| | 5,825 | 32.8% | 7,792 | 34.6% | 1,967 | 25.2% |
| Selling, general and administrative expenses: | | | | | | |
| Transaction Services | 11,203 | 63.0% | 11,652 | 51.8% | 449 | 3.9% |
| Laboratory Communication Solutions | 730 | 4.1% | 910 | 4.0% | 180 | 19.8% |
| | 11,933 | 67.2% | 12,562 | 55.8% | 629 | 5.0% |
| Write-off of impaired assets: | | | | | | |
| Transaction Services | 95,675 | 538.4% | | 0.0% | (95,675) | |
| Laboratory Communication Solutions | | 0.0% | | 0.0% | | |
| | 95,675 | 538.4% | | 0.0% | (95,675) | |
| Depreciation and amortization: | | | | | | |
| Transaction Services | 2,409 | 13.6% | 2,450 | 10.9% | 41 | 1.7% |
| Laboratory Communication Solutions | 112 | 0.6% | 157 | 0.7% | 45 | 28.7% |
| | 2,521 | 14.2% | 2,607 | 11.6% | 86 | 3.3% |
| Operating income (loss): | | | | | | |
| Transaction Services | (98,568) | -554.8% | (959) | -4.3% | (97,627) | |
| | 401 | 2.3% | 509 | 2.3% | (108) | |

Laboratory Communication
Solutions

| | | | | | | |
|----------------------------|-------------|---------|------------|-------|-------------|-------|
| | (98,185) | -552.6% | (450) | -2.0% | (97,735) | |
| Interest expense, net | 419 | 2.4% | 503 | 2.2% | 84 | 16.7% |
| Other (income) expense | 175 | | | | (175) | |
| Loss before income taxes | (98,779) | | (953) | | (97,826) | |
| Provision for income taxes | | | 75 | | 75 | |
| Net loss | \$ (98,779) | | \$ (1,028) | | \$ (97,751) | |

Table of Contents**Results of Operations****Three Months Ended September 30, 2005 Compared to Three Months Ended September 30, 2004**

Total net revenues decreased \$4.7 million, or 21.1%, to \$17.8 million for the three months ended September 30, 2005 compared to \$22.5 million for the three months ended September 30, 2004.

Net revenues in our Transaction Services segment decreased by \$3.9 million, or 20.7%, for the three months ended September 30, 2005 compared to the same period in 2004. This decrease is primarily due to volume declines in the cost containment services as key customers (TPAs) are losing covered lives due to increased competition in the marketplace. Additionally, revenues from our EDI business also declined due to competitive pressures in the market and the shift of certain payers to a non-par basis. We believe that revenues in this segment will remain flat throughout the remainder of 2005.

A summary of the number of transactions we processed for the periods presented is as follows:

| In thousands (unaudited) | Three Months Ended | | | |
|--------------------------|--------------------|--------|---------|----------|
| | September 30, | | | |
| | 2005 | 2004 | Change | % Change |
| Core transactions | 63,255 | 63,677 | (422) | -1% |
| Encounters | 3,986 | 6,561 | (2,575) | -39% |
| | 67,241 | 70,238 | (2,997) | -4% |

Laboratory Communication Solutions segment net revenues decreased \$0.8 million, or 22.8%, for the three months ended September 30, 2005 compared to the same period last year. The decrease is primarily due to the lower revenues from our largest customer. We do not anticipate significant growth from this segment during the remainder of 2005 and throughout 2006.

Total cost of sales decreased \$2.0 million, or 25.2%, to \$5.8 million, for the three months ended September 30, 2005, compared to \$7.8 million for the same period last year.

Cost of sales in our Transaction Services segment consists of transaction fees, provider network outsourcing fees, services and license fees, third-party electronic transaction processing costs, certain telecommunication and co-location center costs, revenue sharing arrangements with ProxyMed's business partners, and third-party database licenses. Cost of sales decreased \$1.5 million, or 25.6% to \$4.4 million, for the three months ended September 30, 2005 compared to \$5.9 million for the same period last year. Gross margins on transaction services were 71.0% in the three months ended September 30, 2005 and 69.0% in the same period in 2004.

Cost of sales in the Laboratory Communication Solutions segment includes hardware, third party software, consumable materials, direct manufacturing labor and indirect manufacturing overhead. Cost of sales decreased \$0.5 million, or 24.2%, to \$1.4 million for the three months ended September 30, 2005 compared to \$1.9 million for the same period in 2004. Gross margins in this segment were 45.8% for the three months ended September 30, 2005, compared to 44.8% for the same period last year.

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Total selling, general and administrative (SG&A) expenses decreased \$0.6 million, or 5% to \$11.9 million for the three months ended September 30, 2005, compared to \$12.5 million for the same period in 2004. This decline includes payroll cost savings in connection with the workforce reduction in August 2005, offset by severance (\$0.5 million) as a result of the personnel reductions.

Transaction Services segment SG&A expenses decreased \$0.4 million or 3.8%, to \$11.2 million for the three months ending September 30, 2005, compared to \$11.6 million for the same period last year. This decrease is primarily due to lower personnel costs related to a reduction in workforce in August 2005 coupled with lower professional fees and selling expenses offset by higher than anticipated employee benefit costs related to our self insurance plan and severance (\$0.5 million) due to the aforementioned workforce reduction.

Laboratory Communication Solutions segment SG&A expenses decreased \$0.2 million or 19.8% to \$0.7 for the three months ended September 30, 2005, compared to \$0.9 million for the same period last year.

Impairment charges. As a result of our stock price decline and reorganization during the third quarter of 2005, we performed a goodwill impairment test as of September 30, 2005. In accordance with the provisions of SFAS No. 144, we used a discounted cash flow analysis which indicated that the book value of the Transaction Services segment exceeded its estimated fair value and that goodwill impairment had occurred. In addition, as a result of the goodwill analysis, we assessed whether there had been an impairment of our long-lived assets in accordance with SFAS No. 144. We concluded that the book value of certain intangible assets was higher than their expected future cash flows and that impairment had occurred. In addition, we also reduced the remaining useful lives of other intangible assets based on the foregoing analysis. Accordingly, we recorded a non-cash impairment charge of \$95.7 million at September 30, 2005 in our Transaction Services segment. The charges included \$68.1 million impairment of goodwill and \$27.6 million impairment of certain other intangibles.

Depreciation and amortization expense for the three months ended September 30, 2005 was \$2.5 million compared to \$2.6 million for the same period last year.

As a result of the foregoing, the operating loss for the three months ended September 30, 2005 was \$98.2 million compared to an operating loss of \$0.5 million for the same period last year.

Net interest expense for the three months ended September 30, 2005 was \$0.4 million compared to \$0.5 million for the same period last year.

Other expense for the three months ended September 30, 2005 was \$0.2 million. This amount was incurred as a result of a litigation settlement.

As a result of the foregoing, net loss for the three months ended September 30, 2005 was \$98.8 million compared to \$1.0 million for the same period last year.

Table of Contents**Nine Months Ended September 30, 2005 Compared to Nine Months Ended September 30, 2004**

| In thousands (unaudited) | Nine Months Ended September 30, | | | | | |
|---|---------------------------------|-------------------------|-----------|-------------------------|-----------|-----------|
| | 2005 | % of Net Revenues | 2004 | % of Net Revenues | Change \$ | Change % |
| Net revenues: | | | | | | |
| Transaction Services | \$ 51,264 | 85.1% | \$ 52,117 | 77.0% | \$ (853) | -1.6% |
| Laboratory Communication Solutions | 9,000 | 14.9% | 15,548 | 23.0% | (6,548) | -42.1% |
| | 60,264 | 100.0% | 67,665 | 100.0% | (7,401) | -10.9% |
| Cost of sales: | | | | | | |
| Transaction Services | 16,043 | 26.6% | 16,015 | 23.7% | (28) | -0.2% |
| Laboratory Communication Solutions | 4,837 | 8.0% | 9,882 | 14.6% | 5,045 | 51.1% |
| | 20,880 | 34.6% | 25,897 | 38.3% | 5,017 | 19.4% |
| Selling, general and administrative expenses: | | | | | | |
| Transaction Services | 35,085 | 58.2% | 31,826 | 47.0% | (3,259) | -10.2% |
| Laboratory Communication Solutions | 2,037 | 3.4% | 3,612 | 5.3% | 1,575 | 43.6% |
| | 37,122 | 61.6% | 35,438 | 52.4% | (1,684) | -4.8% |
| Write-off of impaired assets: | | | | | | |
| Transaction Services | 95,675 | 158.8% | | 0.0% | (95,675) | |
| Laboratory Communication Solutions | 741 | 1.2% | | 0.0% | (741) | |
| | 96,416 | 160.0% | | 0.0% | (96,416) | |
| Depreciation and amortization: | | | | | | |
| Transaction Services | 7,249 | 12.0% | 6,423 | 9.5% | (826) | -12.9% |
| Laboratory Communication Solutions | 438 | 0.7% | 663 | 1.0% | 225 | 33.9% |
| | 7,687 | 12.8% | 7,086 | 10.5% | (601) | -8.5% |
| Operating income (loss): | | | | | | |
| Transaction Services | (102,788) | -170.6% | (2,147) | -3.2% | (100,641) | -4687.5% |
| Laboratory Communication Solutions | 947 | 1.6% | 1,391 | 2.1% | (444) | -31.9% |
| | (101,841) | -169.0% | (756) | -1.1% | (101,085) | -13371.0% |
| Interest expense, net | 1,440 | 2.4% | 1,380 | 2.0% | (60) | -4.3% |
| Other (income) expense | 175 | | (134) | -0.2% | (309) | |
| Loss before income taxes | (103,456) | | (2,002) | | (101,454) | |

| | | | |
|----------------------------|--------------|------------|--------------|
| Provision for income taxes | | 225 | 225 |
| Net loss | \$ (103,456) | \$ (2,227) | \$ (101,229) |

Total net revenues decreased \$7.4 million, or 10.9%, to \$60.3 million for the nine months ended September 30, 2005 compared to \$67.7 million for the nine months ended September 30, 2004.

Net revenues in our Transaction Services segment decreased by \$0.9 million, or 1.6%, for the nine months ended September 30, 2005 compared to the same period in 2004. This decrease is primarily due to lower revenues from our EDI business due to competitive pressures in the market and the shift of payers to a non-par basis. We expect this trend to stabilize for the remainder of 2005. This was partially offset by an increase in revenues from cost containment services due to two additional months included in 2005 revenues compared to 2004. However, the cost containment business volume also declined throughout 2005 as key customers (TPAs) are losing covered lives due to increased competition in the marketplace. We expect this trend to stabilize throughout the remainder of 2005.

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A summary of the number of transactions we processed for the periods presented is as follows:

| In thousands (unaudited) | Nine Months Ended September 30, | | | |
|--------------------------|---------------------------------|---------|---------|----------|
| | 2005 | 2004 | Change | % Change |
| Core transactions | 200,964 | 190,260 | 10,704 | 6% |
| Encounters | 14,913 | 22,614 | (7,701) | -34% |
| | 215,877 | 212,874 | 3,003 | 1% |

Laboratory Communication Solutions segment net revenues decreased \$6.5 million, or 42.1%, to \$9.0 million for the nine months ended September 30, 2005 compared to the same period last year. This decrease in revenues is primarily due to the sale of our contract manufacturing assets in June 2004 and lower revenues from our largest customer. We do not anticipate significant growth from this segment through the remainder of 2005 and throughout 2006.

Total cost of sales decreased \$5.0 million, or 19.4%, to \$20.9 million, for the nine months ended September 30, 2005, compared to \$25.9 million for the same period last year.

Cost of sales in our Transaction Services segment consists of transaction fees, provider network outsourcing fees, services and license fees, third-party electronic transaction processing costs, certain telecommunication and co-location center costs, revenue sharing arrangements with ProxyMed's business partners, and third-party database licenses. Cost of sales for the nine months ended September 30, 2005 was unchanged at \$16.0 million compared to the same period last year. Gross margins on transaction services were 68.7% for the nine months ended September 30, 2005 compared to 69.2% for the same period last year.

Cost of sales in the Laboratory Communication Solutions segment includes hardware, third party software, consumable materials, direct manufacturing labor and indirect manufacturing overhead. Cost of sales decreased \$5.1 million, or 51.3%, to \$4.8 million for the nine months ended September 30, 2005 compared to \$9.9 million for the same period in 2004. This decrease is primarily due to the reduction in SG&A expenses related to the sale of our contract manufacturing assets in June 2004 and lower revenues related to our largest customer.

Total SG&A expenses increased \$1.7 million or 4.9%, to \$37.1 million compared to \$35.4 million for the same period in 2004.

Transaction Services segment SG&A expenses increased \$3.3 million or 10.2%, to \$35.1 million for the nine months ending September 30, 2005, compared to \$31.8 million for the same period last year. This increase is primarily due two more months of SG&A expenses in 2004 related to the PlanVista acquisition in March 2004, severance payments (\$0.5 million) related to the reduction in workforce in August 2005 and higher benefit costs related to our self insurance plan partially offset by lower payroll related to the workforce reduction and the reclassification of bad debt expense as a reduction of gross revenues in the 2005 period.

Laboratory Communication Solutions segment SG&A expenses decreased \$1.5 million or 42.8% to \$2.1 million for the nine months ended September 30, 2005, compared to \$3.6 million for the same period last year. This decrease is primarily due to the reduction in SG&A expenses related to the sale of our contract manufacturing assets in this segment in June 2004.

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Impairment charges. As a result of our stock price decline and reorganization during the third quarter of 2005, we performed a goodwill impairment test as of September 30, 2005. In accordance with the provisions of SFAS No. 142, we used a discounted cash flow analysis which indicated that the book value of the Transaction Services segment exceeded its estimated fair value and that goodwill impairment had occurred. In addition, as a result of the goodwill analysis, we assessed whether there had been an impairment of our long-lived assets in accordance with SFAS No. 144. We concluded that the book value of certain intangible assets was higher than their expected future cash flows and that impairment had occurred. In addition, we also reduced the remaining useful lives of other intangible assets based on the foregoing analysis. Accordingly, we recorded a non-cash impairment charge of \$95.7 million at September 30, 2005 in our Transaction Services segment. The charges included \$68.1 million impairment of goodwill and \$27.6 million impairment of certain other intangibles.

In June 2005, we recorded an impairment charge of \$0.7 million in our Laboratory Communications Solutions segment as a result of the substantial revenue decline of a certain customer. In accordance with the provisions of SFAS No. 144, the Company prepared a discounted cash flow analysis which indicated the carrying value of the intangible asset associated with this customer was greater than the fair value and the impairment had occurred.

Depreciation and amortization expense increased \$0.6 million or 8.5% to \$7.7 million for the nine months ended September 30, 2005, compared to \$7.1 million for the same period last year. The increase was primarily in the Transaction Services segment due to two additional months of amortization expense for intangible assets related to the PlanVista acquisition in March 2004; offset by a decrease in depreciation expense related to the sale of our contract manufacturing assets in the Laboratory Communication Solutions segment in June 2004.

As a result of the foregoing, the operating loss for the nine months ended September 30, 2005 was \$101.8 million compared to an operating loss of \$0.8 million for the same period last year.

Net interest expense for each of the nine months ended September 30, 2005 and 2004 was \$1.4 million.

Other expense for the nine months ended September 30, 2005 was \$0.2 million. This amount was incurred as a result of a litigation settlement (see Note 9(a)). Other income for the same period last year related to a gain in the settlement of a liability assumed in a prior acquisition.

As a result of the foregoing, net loss for the nine months ended September 30, 2005 was \$103.5 million compared to \$2.2 million for the same period last year.

Liquidity and Capital Resources

During the nine months ended September 30, 2005, net cash provided by operating activities totaled \$4.3 million. Cash used by investing activities totaled \$2 million primarily for the funding of capital expenditures related to our technical infrastructure, administrative systems and capitalized development of internal systems. Cash used in financing activities totaled \$7.9 million for the funding of repayments of notes payable, other long-term debt, and payments related to capital leases partially offset by proceeds from the sale of our common stock to our CEO in the second quarter.

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On April 18, 2005, we closed a new three year, \$15.0 million senior asset based facility which is secured by all assets of the combined entities with Wachovia Bank, N.A. The loan is based on qualified accounts receivable and historical cash flows. It bears interest at LIBOR (London Interbank Offering Rate) plus 2.7% and is paid monthly in arrears. This debt contains certain covenants. The principal debt covenants require us to maintain a bank balance of at least \$5.0 million and meet certain historical earnings as defined in the agreement. If we fail to meet any of the covenants, repayment of the debt outstanding under the revolving credit facility may be accelerated. The \$15.0 million loan reduces to \$12.5 million in June 2006 and is all due at maturity on April 17, 2008, absent an event of default. We used the proceeds from this facility and some of our cash to pay approximately \$18.9 million which constituted our entire previous senior related party debt obligation and notes outstanding to former directors of PlanVista including all accrued interest.

During the second quarter of 2005, we defaulted on a financial covenant under this credit facility. We subsequently obtained a waiver of this default and renegotiated the covenant.

During the third quarter of 2005, we were in compliance with all financial covenants related to this credit facility.

As of September 30, 2005, our principal source of liquidity is our cash and revolving credit facility. Based on our current projections, we may be required to use a portion of this \$5.0 million minimum balance as a source of cash. We are currently negotiating with third party financing companies in order to replace the current senior debt facility. There is no assurance that these negotiations will result in terms that are favorable to us or on terms that are better than our current senior debt facility.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of our consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions, but we believe that any variation in results would not have a material effect on our financial condition. We evaluate our estimates on an ongoing basis.

We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements. For a detailed discussion on the application of these and other accounting policies, see Note 1 in the Notes to Consolidated Financial Statements of ProxyMed's Form 10-K/A for the year ended December 31, 2004.

Revenue Recognition Revenue is derived from our Transaction Services and Laboratory Communication Solutions segments.

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Revenues in our Transaction Services segment are recorded as follows:

For revenues derived from insurance payers, pharmacies, and submitters, such revenues are recognized on a per transaction basis or flat fee basis in the period the services are rendered.

Revenue from our medical cost containment business is recognized when the services are performed and are recorded net of estimated allowances. These revenues are primarily in the form of fees generated from discounts we secure for payers that access our provider network.

Revenues associated with revenue sharing agreements are recorded on a per transaction basis or a percentage of revenue basis and may involve increasing amounts or percentages based on transaction or revenue volumes achieved. This treatment is in accordance with Emerging Issues Task Force No. 99-19, Reporting Revenue Gross as a Principal Versus Net as an Agent.

Revenue from certain up-front fees is recognized ratably over three years, which is the expected life of the customer. This treatment is in accordance with Staff Accounting Bulletin No. 104, Revenue Recognition (SAB No. 104).

Revenue from support and maintenance contracts is recognized ratably over the contract period.

Revenues in our Laboratory Communication Solutions segment are recorded as follows:

Revenue from support and maintenance contracts is recognized ratably over the contract period.

Revenues from the sale of inventory and manufactured goods is recognized when the product is delivered, price is fixed or determinable, and collectibility is probable. This treatment is in accordance with SAB No. 104.

Revenue from the rental of laboratory communication devices is recognized ratably over the period of the rental contract.

Capitalized Software Development and Research and Development Costs incurred internally and fees paid to outside contractors and consultants during the application development stage of our internally used software products are capitalized. Costs of upgrades and major enhancements that result in additional functionality are also capitalized. Costs incurred for maintenance and minor upgrades are expensed as incurred. All other costs are expensed as incurred as research and development expenses (which are included in Selling, general and administrative expenses). Application development stage costs generally include software configuration, coding, installation to hardware and testing. Once the project is completed, capitalized costs are amortized over their remaining estimated economic life. Our judgment is used in determining whether costs meet the criteria for immediate expense or capitalization. We periodically review projected cash flows and other criteria in assessing the impairment of any internal-use capitalized software and take impairment charges as needed.

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Reserve for Revenue Adjustments/Doubtful Accounts/Bad Debt Estimates We rely on estimates to determine the revenue adjustments, bad debt expense and the adequacy of the reserve for doubtful accounts receivable. These estimates are based on our historical experience, including historical collection ratios, and the industry in which the customer operates. If the financial condition of a customer were to deteriorate, resulting in an impairment of its ability to make payments, additional allowances are made.

New Accounting Pronouncements

In May 2005, the Financial Accounting Standards Board (FASB) issued SFAS No. 154, Accounting Changes and Error Corrections. SFAS No. 154 requires retrospective application of a voluntary change in accounting principle to prior period financial statements unless it is impractical. SFAS No. 154 also requires that a change in method of depreciation, amortization, or depletion for long-lived, non-financial assets be accounted for as a change in accounting estimate effected by a change in accounting principal. SFAS No. 154 replaces APB Opinion No. 20, Accounting Changes, and SFAS No. 3, Reporting Accounting Changes in Interim Financial Statements. SFAS No. 154 is effective for fiscal years beginning after December 15, 2005. The Company does not expect the adoption of the provision of SFAS No. 154 to have a material impact on its result of operations or financial condition.

In March 2005, the SEC issued SAB No. 107. This SAB provides guidance related to the application of SFAS No. 123R, Shared-Based Payments (Revised 2004) for transactions with non-employees, the transition from nonpublic to public entity status, valuation methods, the accounting for certain redeemable financial instruments issued under share-based payment arrangements, the classification of compensation expense, non-GAAP financial measure, first-time adoption of SFAS 123R and disclosures in Management s Discussion and Analysis (MD&A) subsequent to adoption of SFAS 123R. The revised effective date of SFAS No. 123R is for annual reporting periods beginning after June 15, 2005. The adoption date for us is January 1, 2006. We have not completed the process of evaluating the impact that will result from adopting SFAS 123R and is therefore unable to disclose the impact that adoption will have on our financial position and results of operations.

In September 2004, the FASB issued EITF No. 04-8, Accounting Issues Related to Certain Features of Contingently Convertible Debt and the Effect on Diluted Earnings per Share (EITF No. 04-8). EITF No. 04-8 addresses when the dilutive effect of contingently convertible debt instruments should be included in diluted earnings per share and requires that contingently convertible debt instruments are to be included in the computation of diluted earnings per share regardless of whether the market price or other trigger has been met. EITF No. 04-8 also requires that prior period diluted earnings per share amounts presented for comparative purposes be restated. EITF No. 04-8 is effective for reporting periods ending after December 15, 2004. As a result of the issuance of EITF No. 04-8, shares convertible from our \$13.1 million convertible notes may be required to be included in the calculation of our earnings per share in periods of net income; however, the FASB has yet to reach a conclusion as to the effect of non market price triggers on earnings per share calculations in situations where the instrument contains only non-market price trigger, such as our convertible notes, and therefore the impact on the consolidated financial statements is not determinable at this time.

In November 2004, the FASB issued SFAS No. 151, Inventory Costs, an amendment of ARB No. 43, Chapter 4. This Statement clarifies the accounting for abnormal amounts of idle facility

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expense, freight, handling costs, and spoilage and requires that those items be recognized as current-period charges regardless of whether they meet the criterion of so abnormal under ARB No. 43. The provisions of this Statement shall be effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The Company does not expect the adoption of the provision of SFAS No. 154 to have a material impact on its result of operations or financial condition.

Cautionary Statement Pursuant to Safe Harbor Provisions of the Private Securities Litigation Reform Act of 1995

Statements contained in the MD&A and elsewhere in this report may contain information that includes or is based upon forward-looking statements within the meaning of the Securities Litigation Reform Act of 1995. Forward-looking statements present our expectations or forecasts of future events. These statements can be identified by the fact that they do not relate strictly to historical or current facts. They frequently are accompanied by words such as anticipate, estimate, expect, project, intend, plan, believe, and other words and terms of similar meaning. In particular, these include statements relating to: our successful integration of past and any other future acquisitions; our ability to successfully develop, market, sell, cross-sell, install and upgrade our clinical and financial transaction services and applications to new and current physicians, payers, medical laboratories and pharmacies; our ability to compete effectively on price and support services; our ability to increase revenues and revenue opportunities; continued and increasing the growth of our Transaction Services segment; our ability to successfully resolve litigation; our ability to comply with governmental regulation of the industry; and our ability to meet expectations regarding future capital needs and the availability of credit and other financing sources.

All statements other than statements of historical fact are statements that could be deemed forward-looking statements, including any projections of earnings, revenues, synergies, accretion, margins or other financial items; any statements of the plans, strategies and objectives of management for future operations, including the execution of integration and restructuring plans and the anticipated timing of filings, approvals and closings relating to the merger or other planned acquisitions; any statements concerning proposed new products, services, developments or industry rankings; any statements regarding future economic conditions or performance; any statements of belief; and any statements of assumptions underlying any of the foregoing.

Actual results may differ significantly from projected results due to a number of factors, including, but not limited to, the soundness of our business strategies relative to perceived market opportunities; our assessment of the healthcare industry's need, desire and ability to become technology efficient; market acceptance of our products and services; and our ability and that of its business associates to comply with various government rules regarding healthcare information and patient privacy. These and other risk factors are more fully discussed in our Form 10-K/A for the year ended December 31, 2004 filed with the SEC on March 31, 2005, which we strongly urge you to read.

Forward-looking statements are not guarantees of performance. They involve risks, uncertainties and assumptions. Our future results and shareholder values may differ materially from those expressed in the forward-looking statements. Many of the factors that will determine these results and values are beyond our ability to control or predict. Shareholders are cautioned not to put undue reliance on any forward-looking statements. For those statements, we claim the

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protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995. We expressly disclaim any intent or obligation to update any forward-looking statements.

Available Information

Our Internet address is www.proxymed.com. We make available free of charge on or through our Internet website our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after such material is electronically filed with, or furnished to, the SEC.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We do not own derivative financial instruments or derivative commodity instruments. Revenue derived from international sales are transacted in U.S. Dollars and therefore, we are not exposed to material risks related to foreign currency exchange rates.

ITEM 4. CONTROLS AND PROCEDURES

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of September 30, 2005 (as defined in Exchange Act Rule 13a-15(e)). Based upon such evaluation, management has concluded that our disclosure controls and procedures are effective to ensure that the information we are required to disclose in reports that we file or submit under the Exchange Act is communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure, and is recorded, processed, summarized and reported within the time periods specified in the Commission rules and forms.

There have not been any changes in our internal control over financial reporting during this quarter that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

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PART II OTHER INFORMATION

Item 1. Legal Proceedings

In December of 2001, Insurdata Marketing Services, Inc. (IMS) filed a lawsuit against HealthPlan Services, Inc. (HPS), a former subsidiary of PlanVista, for unspecified damages in excess of \$75,000. The complaint alleges that HPS failed to pay commissions to IMS pursuant to an arbitration award rendered in 1996. On January 10, 2005, the court granted summary judgment to IMS on the issue of liability for the arbitration award. We filed an appeal on the issue of liability. On September 26, 2005 we entered into a settlement to pay a total of \$775,000 in exchange for a release from the entire claim, with an initial payment of \$225,000 and the rest due in equal installments over the six months. On October 20, 2005 the first payment of \$225,000 was wired to IMS.

In early 2000, four named plaintiffs filed a class action against Fidelity Group, Inc. (Fidelity), HPS, Third Party Claims Management, and others, for unspecified damages. The complaint stems from the failure of a Fidelity insurance plan, and alleges unfair and deceptive trade practices; negligent undertaking; fraud; negligent misrepresentation; breach of contract; civil conspiracy; and RICO violations against Fidelity and its contracted administrator, HPS. Two principals of the Fidelity plan have been convicted of insurance fraud and sentenced to prison in a separate proceeding. The class has been certified and the case is proceeding in discovery. We are contesting the plaintiffs' claims vigorously, but are unable to predict the outcome of the case or any potential liability. Mediation is scheduled to be held on November 1, 2005.

In 2004, we filed a tax appeal in the State of New York contesting a Notice of Deficiency issued by the State of New York to PlanVista Solutions, Inc. The notice involved taxes claimed to be due for the tax years ending December 31, 1999 through December 31, 2001. The amount due, including interest and penalties through September 30, 2005 is \$3.1 million. We recently withdrew the tax appeal and entered into an installment payment agreement with the State of New York. Payment on the tax liability will be repaid in a lump sum of \$500,000 by October 30, 2005 and the remainder in equal installments beginning in November 2005 with the State of New York. We entered into an agreement with a third party to be reimbursed for 70% of the liability ultimately agreed to with the State of New York, but not to exceed \$2 million. We received the \$2.0 million payment from the third party in September 2005.

In December 2004, Honolulu Disposal, Inc. et al sued American Benefit Plan Administrators, Inc. (a former subsidiary of PlanVista Corporation) in the Circuit Court of the First Circuit of the state of Hawaii alleging damages of \$5,700,000 for failure to properly conduct a payroll audit during the period of 1982 through 1996. Discovery is now underway in the case and facts are being developed. We are contesting the plaintiffs' claims vigorously, but are unable to predict the outcome of the case or any potential liability. We are seeking indemnification for defense costs and any liability for damages under the business contracts at issue in the litigation.

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Item 6. Exhibits

The following exhibits are furnished or filed as part of this Report on Form 10-Q:

- 31.1 Certification by John G. Lettko, Chief Executive Office, pursuant to Exchange Act Rules 13a-14 and 15d-14.
- 31.2 Certification by Douglas J. O Dowd, Chief Financial Officer, pursuant to Exchange Act Rules 13a-14 and 15d-14.
- 32.1 Certification by John G. Lettko, Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification by Douglas J. O Dowd, Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

PROXYMED, INC.

Date: November 9, 2005

By: /s/ John G. Lettko

John G. Lettko

Chief Executive Officer

Date: November 9, 2005

By: /s/ Douglas J. O Dowd

Douglas J. O Dowd

Chief Financial Officer

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